

April 10, 2015

The Honorable Chuck Grassley  
135 Hart Senate Office Building  
Washington, DC 20510

The Honorable Michael Enzi  
379A Russell Senate Office Building  
Washington, DC 20510

The Honorable Debbie Stabenow  
731 Hart Senate Office Building  
Washington, DC 20510

RE: Submission to the Senate Finance Committee, Individual Income Tax Working Group

Dear Co-Chairs Grassley, Enzi, and Stabenow,

Save the Children Action Network (SCAN) is submitting these proposals to the Individual Income Tax Working Group of the Senate Finance Committee in support of early childhood education. We believe existing mechanism within the individual tax code can be revised and expanded to not only better support preschool and pre-kindergarten educational programs, but also to enhance the fairness of these provisions. SCAN's recommendations fall into two categories: the first is expanding tax credits and deductions for early learning already in place, and the second is pursuing parity between higher education and early education provisions.

### **Expanding Existing Tax Credits and Deductions**

The federal government provides approximately \$3 billion annually in tax credits to individuals and employers supporting early childcare and education. These credits could be improved in several ways, making them fairer and enhancing their value for working low-income families.

The federal Child and Dependent Care Tax Credit (CDCTC) helps reduce an individuals' employment-related child care costs by providing a non-refundable tax credit of between 20% and 35% of the first \$3,000 spent on care for one child, and the first \$6,000 on care for two or more children. The credit is determined on a sliding income scale, and net can be worth as much as \$2,100.

In practice, the way the credit is currently constructed is suboptimal for low-income families, both because the credit is only worth up to 35% of what is spent and the credit is non-refundable, meaning you cannot be reimbursed for more than your total tax liability. For example, a single parent earning \$15,000 and spending \$1,200 on child care would only qualify for a \$86 credit, as that is the total tax she owes. Many low-income families owe little or no tax, so the credit is virtually useless for them. On the other hand, high-income families can take full advantage of the credit.

The CDCTC should be improved by making it fully refundable and increasing its value, and there is precedent for this at the state level. Thirteen states have improved the credit by making it either fully or partially refundable to benefit low-income families with little-to-no income tax liability. Other states, specifically Maine, Vermont, and Arkansas, have improved the CDCTC by increasing the value of the credits for higher quality childcare. These both serve as options for improving the federal CDCTC and providing low-income working families with additional resources for childcare. Congress should also raise the ceiling on eligible expenses to more closely reflect the actual costs of quality childcare.

The National Women's Law Center supported similar changes to the CDCTC in its submission to the House Ways and Means Tax Reform Working Group on Education and Family Benefits in April, 2013. This organization advocated for a fully refundable CDCTC with expense limits indexed for inflation.

In addition to the CDCTC, the federal government subsidizes individuals' childcare expenses through the employer-provided childcare exclusion. The exclusion allows employees to pay for up to \$5,000 in child care with pre-tax dollars. To take advantage of this exclusion, employees must arrange the exclusion of up to \$5,000 in pre-tax dollars from their salary. The exclusion applies to both payroll (FICA) and income taxes.

There is room to improve the employer-provided childcare exclusion. First, it is only available to taxpayers whose employers offer the exclusion. Second, like the CDCTC, the exclusion is fixed and not indexed for inflation, and it is capped at \$5,000 regardless of the number of children needing care. Congress should increase the maximum allowable exclusion to better reflect the actual cost of childcare, make the exclusion available on a per child basis, and index the credit for inflation.

### **Higher Ed – Early Ed Parity**

The federal government provides financial assistance for higher education expenses in two ways: tax benefits and traditional student aid (loans, grants, and work-study assistance). There are 14 tax benefits (credits, deductions, and exclusions) currently available for college students and their parents to help pay for higher education. We ask that these benefits be extended so they apply to early education in addition to higher education, a concept we have termed Higher Ed – Early Ed Parity. In doing so, the individual tax code would achieve an increased level of fairness between educations that occur outside the public K through 12 system.

We have looked at two categories of education tax benefits: incentives for current year expenses, and incentives for saving for college. Focusing on incentives for current year expenses, the Hope Tax Credit, temporarily replaced by the American Opportunity Tax Credit (AOTC), is a \$2,500 credit (40% refundable up to \$1,000) per student for post-secondary expenses including tuition, fees, books, and supplies. The AOTC should be expanded to include parents' expenses related to pre-kindergarten education, operating in conjunction with the Child and Dependent Care Tax Credit.

There is also the Lifetime Learning Credit that helps individuals pay for tuition and related expenses for higher education. The credit is nonrefundable, and worth up to \$2,000 per tax return. This credit should also be expanded to include parents' qualified early education and care expenses.

Scholarships, fellowships, and tuition reductions for qualified higher education expenses are also excluded from income for tax purposes. This same exclusion from income does not apply for early education expenses, however. The exclusion from income should be expanded to include tuition reductions or financial assistance for preschool and early childhood care.

There are also preferential savings vehicles to help pay for K-12 and higher education that do not apply to pre-kindergarten education. Coverdell education savings accounts, for example, are accounts set up to pay the qualified education expenses of a designated beneficiary. They allow families to invest up to \$2,000 per year per beneficiary to grow tax free until distributed. The savings account can then be used to pay for qualified education expenses at either an eligible postsecondary school or an eligible elementary or secondary school. The eligible educational institutions for Coverdell accounts should be expanded to include pre-kindergarten programs. Of note, currently the value of tax free growth for only the few years between a child's birth (at which point the child can be designated as a beneficiary) and when the child begins preschool is minimal. However, if Coverdell accounts could be set up in advance of a beneficiary's birth, it would significantly increase the value of this savings vehicle for pre-kindergarten education. This same model of expansion should also be applied to Section 529 Plans, as well as the cancellation of the early IRA withdrawal penalty for qualifying education expenses.

Lastly, in the context of overall tax reform, SCAN believes in ensuring that any reform package is distributionally-neutral across income levels. This was a top goal of former House Ways and Means Chairman Dave Camp (R-MI) in the tax reform discussion draft he released in 2014. Enhancing early childhood education credits and deductions for low and moderate-income families, as we have suggested above, is an effective method of helping ensure distributional neutrality through tax reform in a socially conscience manner.

We appreciate this opportunity to submit suggestions to the Senate Finance Committee Tax Reform Working Group on Individual Income Tax, and we would be glad to provide the panel with any additional information. Please do not hesitate to contact us if you have any questions.

Best regards,



Mark Shriver  
President  
Save the Children Action Network